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SIPDIS

SENSITIVE

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TAGS: EFIN ECON ETRD BG
SUBJECT: READOUT ON IMF VISIT TO BANGLADESH

¶1. (SBU) Summary: An IMF team visited Bangladesh from March 27 to April 9 to hold Article IV consultations and the third review of the economic program supported by the Poverty Reduction and Growth Facility (PRGF). The team's overall assessment was positive. Bangladesh is on target for approval in June of an additional $105 million tranche under the PRGF. End summary.

¶2. (SBU) IMF resident representative Jonathan Dunn briefed local donors and diplomats on April 17 on the results of the IMF team visit to Bangladesh. The team cited strong economic growth in the first half of FY 2005 (July - December, 2004), driven by expansion in the construction, manufacturing and services sectors and a strong recovery in exports. IMF projects GDP growth for FY 2005 at 5.3-5.5 percent, somewhat below ADB projections of 6 percent. Inflation remains moderate (5.5% through December 2004) but is accelerating, mainly due to rising energy and food costs.

¶3. (SBU) Revenues are somewhat below annualized projections; however, receipts are historically higher in the last quarter (March-June) and could follow a similar pattern this year. IMF believes effective enforcement, not tax increases, is the key to improving tax revenues. IMF advocates a restructuring of the National Board of Revenue (NBR) along functional lines. This would replace the current structure based on tax categories (customs, excise, VAT and income). An NBR plan to hire an "audit czar" to oversee all auditing functions is seen as a step in the right direction.

¶4. (SBU) The IMF also recommends a review of the extensive zero rate tariff classifications, recommending substitution of a small marginal rate. Unlike dutiable goods, zero rate goods are not subject to pre-shipment verification; hence, many dutiable goods are "misclassified" into zero-rate tariff items.

¶5. (SBU) Foreign exchange reserves remain steady at $3 billion, equivalent to three months of imports. Rising costs of imported commodities, especially rice, scrap metal and energy are putting pressure on foreign reserves. High demand for capital machinery imports is also creating pressures on reserves. These pressures are offset, however, by continued strong remittances and an increase in the country's credit line from Islami Development Bank for energy purchases. The taka continues to depreciate slightly against the dollar, which the IMF views positively.

¶6. (SBU) Real interest rates remain close to zero and are low for the region. Low interest rates are one factor in the rapid expansion of credit and are fueling construction and investment in the manufacturing sector. The uncertain fate of tax holidays for new investment, scheduled to expire in June 2005, is a contributing factor. The IMF has recommended that the tax holiday program (typically valid for five years) not be renewed, and the BDG has shown some willingness to adopt the IMF's recommendation. Predictably, however, the potential end of cheep/free money and tax breaks has brought howls of protest from politically powerful industrialists. According to Dunn, the IMF questions whether the BDG will find the political will to follow through, especially with the upcoming 2006/07 elections.

¶7. (SBU) The IMF is projecting continued growth in exports at 4-5% for FY 2005, and acknowledges this figure could be low. (ADB and government projections are nearly double the IMF figure.) FY 2005 figures do not fully reflect the impact of the end of the Multi-Fiber Arrangement, as current ready-made garment (RMG) exports are still filling orders placed in fall, 2004. As the order lag works through the system, export growth could slow. That said, IMF cited consolidation in the weaker parts of the RMG sector and continuing new investment in competitive factories as positive signs. The woven and knitwear sectors in particular are benefiting from low and duty free access to EU markets; however, potential changes in EU GSP programs could have a negative effect on Bangladesh.

¶8. (SBU) Finally, the IMF reported reaching a new agreement on the sale of the Rupali national commercial bank, bringing Bangladesh back on track to receive the next tranche under the PRGF. The management team in place at Agrani bank is working well with bank management and a similar team is

expected to be in place shortly at Janata bank. The BDG remains reluctant to denationalize Sonali bank, but does have a competent management team in place, the team said.
THOMAS